E. AMATEUR ATHLETIC ORGANIZATIONS

1. Background

Dateline: The Montreal Olympics, July 1976. The United States wins "only" 34 gold medals. The USSR wins 47. East Germany wins a "surprising" 40 events.

2. The Tax Reform Act of 1976

The Tax Reform Act of 1976 amended IRC 501(c)(3) to exempt from federal income tax organizations organized and operated exclusively to foster national or international amateur sports competition. These organizations qualify for exemption only if no part of their activities involves the provision of athletic facilities or equipment.

The legislative history behind this amendment is skimpy because it was introduced as an unprinted amendment during the Senate consideration of the Act. The Senate was thinking primarily about the need to aid those amateur sports organizations that could not get adequate funding because they could not qualify under IRC 501(c)(3). These organizations, as identified by Congress in the Senate Congressional Record dated August 5, 1979, at page S13612, included two types: national organizations that "are responsible for the conduct of national and international competition, including the conducting of national championships and the selection of national teams in Olympic and Pan American sports"; and "national, local, and regional organizations whose primary purpose is supporting and developing amateur athletes for participation in national and international competition in Olympic and Pan American sports." It is important to note that the discussion of the amendment emphasized that "(i)t is not intended to make social clubs, or organizations of casual athletes, into tax-exempt charities. Only an organization whose primary purpose is the support and development of amateur athletes for participation in international competition in Olympic and Pan American sports will qualify under this amendment. Organizations whose primary purposes are the recreation of their members or whose facilities are used primarily by casual athletes will not qualify."

There are no specific references to the Olympic and Pan American games, however, in the Joint Committee Explanation of the Tax Reform Act (reproduced in 1979-3 (Vol. 2) C.B. 435). The prohibition regarding social clubs was broadened to include any organization that made available athletic equipment of

facilities. The explanation also stated that the amendment "is not intended to adversely affect the qualification for charitable tax-exempt status or tax deductible contributions of any organization which would qualify under the standards of prior law."

Proposed regulations, published in the Federal Register (Vol. 44, No. 92) on May 10, 1979, attempt to define what is meant by "foster(ing) national or international amateur sports competition."

[Proposed Regulations not shown here]

The proposed regulations are reasonably self-explanatory with respect to the "shopping list" of what an amateur athletic organization may be allowed to do. However, we expect that a number of problems in handling these organizations will probably arise under proposed Reg. 1.501(c)(3)-1(d)(7) and (8).

Proposed Reg. 1.501(c)(3)-1(d)(7) provides that the term "amateur athletes" refers only to athletes who participate or reasonably can be expected to participate (emphasis added), in national championships or international competition in an amateur sport.

Beginning with the simplest type of case, an application is submitted by an organization that provides coaching for the American swim team in the Pan American games. Coaching is an exempt activity enumerated in the proposed regulations; the Pan American games are an international forum for amateur sports competition. Definitionally, there seems to be no problem with incorporating this kind of organization into the expanded framework of IRC 501(c)(3).

However, what happens when the competitive nature of the event is less apparent? The regulations provide that a nexus be established between the amateur athlete and a national championship or international competition. Proposed Reg. 1.501(c)(3)-1(d)(6)(iii) contemplates "local, regional, and national competition to select participants in national championships or international competition in an amateur sport." Does the national downhill ski competition of lower Manhattan qualify as a national championship/international competition? Probably not; however, what if the event is an internationally known showcase for Olympic caliber athletes?

Proposed Reg. 1.501(c)(3)-1(d)(7) may loosen the requirement of national championship/international competition to a degree. This section would include in

the eligible class of participants those amateur athletes who can reasonably be expected to participate in a national championship/international competition.

Often organizations seeking recognition of exemption as amateur athletic organizations under the expanded IRC 501(c)(3) provision will not be concerned solely with easily recognized championships/international competitions. Rather, they will be concerned with the development of athletes involved in all types of "competition." The specialist handling these cases will have to determine if the makeup of the organization is such that the athletes can reasonably be expected to compete in the program of competition.

For example, organization X is the recognized regulatory authority for a well-known sport. All official activities involving that sport in the region are subject to the supervision of organization X. It sponsors both national and regional competitions designed to identify superior talent for the United States Olympic team in that sport. In addition, organization X seeks to educate the general public in the safe way to participate in the sport. Organization X is involved not only with proven athletes, but also with people just learning the sport; it argues that in order to guarantee competitive teams in the future it is necessary to become involved with participants at all levels of skill.

Organization X does not meet the definition of an amateur athletic organization fostering national or international sports competition. The substantial involvement with all levels of the sport is inconsistent with the definitional requirement that the athletes can "reasonably be expected" to participate in national championships or international competition.

Proposed Reg. 1.501(c)(3)-1(d)(8) excludes from the definition of amateur athletic organizations those organizations providing athletic facilities or equipment. This section implements a clear statutory prohibition. If an organization in <u>any</u> <u>way</u> provides equipment or facilities, it cannot be recognized as exempt as an amateur athletic organization. This absolute prohibition is easy to apply (although "hard" on the organization).

Assume that organization A is involved in training swimmers for the Olympics. All of the athletes can reasonably be expected to compete in national competitions. The organization pays a nominal rent for the use of a regulation size swimming pool. In addition, the organization provides swim suits, kickboards, goggles, and head caps to the trainees. Twice a week the swimmers are videotaped in their practice sessions. These tapes are used for instructional purposes.

The above described organization cannot be recognized as exempt as an amateur athletic organization fostering national or international competition. Clearly, the provision of the pool is a prohibited provision of facilities; and, less clearly perhaps, providing assorted swimming paraphernalia or equipment is inconsistent with the statutory provision. Lastly, the use of the videotape equipment would be construed as providing equipment and facilities.

Consider these examples:

1) An organization is involved in training runners. All of the runners involved can reasonably be expected to compete in national competition. The organization maintains a cross country course provided free of charge by a county government. By maintaining this course, the organization might be deemed to be providing facilities.

2) An organization is sponsoring a team to compete in an international roller skating competition. The organization provides the coaching and transportation of the team. Under international regulations governing the sport, only certain types of skates and skate ball bearings may be used. In order to insure conformity with these regulations, the organization provides the ball bearings used in the competition. The TRA'76 provision contains no "substantiality" test on equipment. Since the organization provides ball bearings (equipment), it probably cannot qualify for exemption.

Based on the above, it would seem that few organizations will be recognized as exempt under the amateur athletic organization provision of the Tax Reform Act of 1976. This is not to say that organizations claiming to promote amateur sports in this country cannot be recognized as exempt under IRC 501(c)(3). Any organization that would be recognized as exempt under IRC 501(c)(3) without regard to the TRA'76 provision (for example an organization combatting juvenile delinquency) should not be denied exemption by virtue of that amendment.

3. IRC 501(c)(3) Exemption for Amateur Athletic Organizations without Regard to the TRA'76

Athletic organizations have a long and checkered history with respect to exemption under IRC 501(c)(3). To some extent, the Service's history with respect to these organizations may have served as an impetus for the TRA'76 enactment.

Congress described IRC 501(c)(3) as "a source of confusion and inequity for amateur sports organizations whereby some gained favored tax-exempt status while others, apparently equally deserving, did not." Joint Committee on Taxation, 94th Cong., 2d Sess., General Explanation of the Tax Reform Act of 1976, 1976-3 (Vol. 2) C.B. 435.

The Service has never held sports to be an exempt activity per se. However, sports has been viewed as a viable means to achieve an otherwise (usually educational) exempt purpose.

In Rev. Rul. 55-587, 1955-2 C.B. 261, the Service recognized as educational an organization that directs and controls interscholastic high school athletic competition; prescribes eligibility rules for contestants and penalties for the violation of such rules, as well as the rules of play in the various sports; conducts sectional, district and state meets or tournaments; arranges schedules for contests; trains and assigns game officials; and makes suitable awards in the state meets.

In Rev. Rul. 65-2, 1965-1 C.B. 227, an organization that conducted sports clinics for student players, provided free instruction, encouraged youth participation in tournaments, and arranged for attendance of players and instructors at state tournaments was held to be educational within the meaning of IRC 501(c)(3).

In Rev. Rul. 64-275, 1964-2 C.B. 142, an organization that was created essentially for the purpose of providing advanced training to suitable candidates in the techniques of racing small sailboats in national and international competition, in order to improve the caliber of candidates representing the United States in the Olympic and Pan American games and other international racing events, was deemed to be educational within the meaning of IRC 501(c)(3).

In Rev. Rul. 77-365, 1977-2 C.B. 192, an organization that provided free instruction in all aspects of a sport through participation in local clinics was exempt under IRC 501(c)(3), even though the class of participants was unlimited.

The above revenue rulings all provide recognition of exemption to athletic organizations under IRC 501(c)(3). However, the athletic organizations were recognized as exempt because they achieve charitable goals without reference to athletics. The Service's position is that teaching a sport may be educational; promoting competition for the sake of competition is not exempt as educational.

In Rev. Rul. 70-4, 1970-1 C.B. 126, an organization that publicized a sport and conducted tournaments but had no regular program of teaching the sport was denied exemption under IRC 501(c)(3) as an educational organization and was characterized as an IRC 501(c)(4) social welfare organization. The Service rejected the contention that this organization was educational:

> .... The organization's activities primarily consist of the promotion and regulation of a sport for amateurs. Promotion and regulation of a sport for amateurs as described neither improve nor develop the capabilities of the individual nor instruct the public on subjects useful to the individual and beneficial to the community within the meaning of the regulations. Therefore, these activities are not educational within the meaning of section 501(c)(3) of the Code.

The Service's policy on amateur sports organizations has evolved from the early Revenue Rulings recognizing as exempt only organizations teaching a sport to children (Rev. Ruls. 55-587 and 65-2) to the most recent "sports" Revenue Rulings (Rev. Rul. 77-365) which holds that teaching a sport to all individuals is exempt. The rationale behind the earlier Revenue Rulings was two-fold:

1) combatting juvenile delinquency; and
2) education.

The Service has steadfastly refused to recognize sports as being an exempt activity in and of itself. The specialist should examine the cases to determine the degree of emphasis placed upon competition. If an organization places an inordinate amount of emphasis on competition, it has removed itself from an educational context. Only if an organization stays within the educational framework outlined in the above Revenue Rulings should it be considered exempt.

We are, however, currently considering two new positions regarding athletic organizations. The first, raised by several organizations, would recognize as exempt an organization that provides a framework for statewide competition in a sport for individuals under 18 years of age. If adopted, this position would again establish a bifurcated system predicated on age for determining whether an amateur sports organization is exempt under IRC 501(c)(3). An organization regulating a sport for adults would still be subject to the restrictions contained in Rev. Rul. 70-4. This position would resurrect the rationale of combatting juvenile delinquency utilized in our earlier Revenue Rulings.

The second position was raised judicially. In Hutchinson Baseball Enterprises, Inc. v. Commissioner of Internal Revenue, 73 T.C. No. 14 (1979), the United States Tax Court classified an amateur baseball team an IRC 501(c)(3) organization. In this case the organization fielded an amateur team in a semi-professional league. The court held that the advancement of amateur athletics in and of itself was an activity consistent with IRC 501(c)(3) exemption (with or without regard to the TRA of 1976 provision).

This decision by the Tax Court substantially deviates from the Service's position on the IRC 501(c)(3) exemption of athletic organizations. At this writing, the Service has not decided whether to appeal or acquiesce. We will keep you advised of developments on this case since we are already receiving applications for recognition of exemption from organizations similar to Hutchinson.

In handling athletic organizations, we should remember that the TRA'76 provision applies only to organizations fostering amateur athletics for the sake of athletic competition. Organizations teaching a sport may qualify for exemption as educational organizations under the general provisions of IRC 501(c)(3).

4. UBIT Developments with Respect to Sports

The Service has not published any new revenue rulings dealing with the unrelated business income of exempt amateur sports organizations.

One important source of income for athletic organizations is selling the right to use the organizations' name, goodwill, etc. The 1979 EOATRI discussion of "Royalties and Exploitation Income", pp. 521-532, explains the royalty exception to the definition of UBI as it relates to IRC 501(c) organizations in general and exempt athletic organizations in particular. You should note, however, that the position described on page 529 probably no longer reflects Service thinking on the issue. It now appears that flat fee payments for the use of an organization's logo will be considered royalties under IRC 512(b)(2), and as such will be excluded from UBI.

Another source of income for athletic organizations is selling broadcast rights to sporting events. The EOATRI topic on The Marketing of Goods and Services by Institutions of Higher Learning discusses the UBI implications of broadcasting sporting events.